IMPOUNDED PROCESSING TAXES AND PROCESSORS' PROFITS

Text of letter of Secretary of Agriculture Wallace

to

Senator George W. Norris

Relating to Processing Taxes Outstanding, Profits of Processors, and Operating and Profit Margins of Processors

With Accompanying Report by L. H. Bean
Economic Adviser
Agricultural Adjustment Administration

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AGRICULTURAL ECONOMICS
U.S. DEPARTMENT OF AGRICULTURE

Agricultural Adjustment Administration
United States Department of Agriculture
February 25, 1936

February 18, 1936

Hon. George W. Norris,

United States Senate.

Dear Senator Norris:

Following your request of February 13, a report has been completed by L. H. Bean, economic adviser of the Agricultural Adjustment Administration, dealing with the amount of processing taxes outstanding as a result of the recent Supreme Court decision, their relation to the profits of processors, and to the operating and profit margins taken by processors before processing taxes were levied, during the period when they were in effect and since January 6 when they ceased to be in effect. A copy of this report is enclosed. The facts embodied in this report indicate that the impounded processing taxes recently ordered returned to processors rather than to consumers or producers is in the nature of an outright gift of public money to a small group that is not entitled to it. The amount involved is over $300,000,000, including impounded as well as other unpaid processing taxes.

The facts show (1) that the impounded and other unpaid processing taxes are far in excess of the annual net earnings of processors; (2) that in the case of cotton, wheat and hog processors as a group, the accumulated unpaid taxes represent about three and a half times their average prosperity net profits of 1927-1929; (3) that in the case of hog processors alone the unpaid taxes are approximately eight times their average prosperity net profits from hogs; and (4) that processors by increasing their operating and profit margins during the period when processing taxes were in effect, have collected the equivalent of the impounded taxes from consumers or producers and are therefore being given money that except for the recent court action would have gone to the public Treasury, where Congress intended it to go.

The argument has recently been made by a spokesman of the large meat packers that the unpaid processing taxes really belong to the processors because a number of the small firms are in financial difficulty.

You will be interested to know that small packing firms, especially in the East, usually find themselves in difficulty when hog production is reduced by crop failures as in 1925 and 1935, that part of their problem is an outgrowth of the long time competitive struggle in this as in many other industries between the large and small units, and that the mere fact of financial difficulties among some small packers is no justification whatever for the desire on the part of the large packers to retain the bulk of the unpaid processing taxes. The bulk of the unpaid processing taxes returned to the large firms has, of course, the effect of intensifying the competitive difficulties of the small firms.

Sincerely yours,

/s/ H. A. Wallace
Secretary

Enclosure

Relation of Impounded Processing Taxes to Processors' Profits

Report Prepared by L. H. Bean, Economic Adviser,
Agricultural Adjustment Administration

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The facts show:

(1) that the impounded and other unpaid processing taxes are far in excess of the annual net earnings of processors;

(2) that in the case of cotton, wheat and hog processors as a group, the accumulated unpaid taxes represent about three and a half times their average prosperity net profits of 1927-1929;

(3) that in the case of hog processors alone the unpaid taxes are approximately eight times their average prosperity net profits from hogs; and

(4) that processors by increasing their operating and profit margins during the period when processing taxes were in effect, have collected the equivalent of the impounded taxes from consumers or producers and are therefore being given money that except for the recent court action would have gone to the public Treasury, where Congress intended it to go.

Relation of Impounded Processing Taxes to Processors' Profits

The amount of money involved in the recent court action ordering impounded processing taxes to be returned to processors instead of consumers or producers is over $300,000,000. This amount includes about $180,000,000 of impounded taxes released as a result of court action and more than $120,000,000 unpaid as a result of delays in payment, delinquencies and failure to file returns.

Of the total amount outstanding, 90 percent is in the hands of three groups of processors: cotton manufacturers, wheat flour millers and hog packers, and by far the largest share in each of these three industries reverts to the few largest firms. The amount of cotton processing taxes unpaid as of December 31, 1935 is estimated at $97,000,000 and of this amount, $51,000,000 is outstanding as a result of court action; the amount of hog processing taxes is estimated at $98,000,000 and of this amount, $51,000,000 is outstanding as a result of court action; the amount of wheat taxes outstanding is estimated at $80,000,000 and of this total, $67,000,000 is outstanding as a result of court action. It should be observed that these estimates do not include the taxes due for the processings of January 1 to January 6, 1936.

It has been argued on strictly legal grounds that since processors were the ones who paid the tax to the U. S. Treasury and since the processing tax has been held unconstitutional by six of the nine Supreme Court Justices, the impounded taxes should be returned to the processors irrespective of whether they paid the tax as collecting agents for the government or actually paid the tax out of their own pockets. It is now argued by certain processors that they have actually paid the tax, that their profits have been reduced, and that they have not actually collected the tax from consumers or from producers. The following facts as to the net income of cotton, wheat and hog processors and unpaid processing taxes indicate clearly the nature of this argument.

Income data reported to the Internal Revenue Bureau annually are available only to 1933. In that year there were returns from 793 cotton textile corporations. Sixty percent of them reported a net profit of $50,000,000 and the other 40 percent reported a net loss of $18,000,000, leaving a net income for the industry of $32,000,000. This industry suffered severe losses in 1930, 1931 and 1932. In 1929 there were 925 cotton textile corporations that reported; a little more than half reporting net incomes of $55,000,000, and the rest reported losses totaling $33,000,000, leaving a net income for the industry as a whole of $22,000,000. For 1928 the net income for the industry was $11,000,000 and for 1927, the year of record cotton consumption, $76,000,000.

The impounded and other outstanding processing cotton taxes of $97,000,000 may thus be compared with the $31,000,000 net income of 1933, with the $22,000,000 of 1929 and with about an average of $35,000,000 for the three years 1927, 1928 and 1929. The impounded processing taxes covering the cotton processed chiefly during only one half year, the last half of 1935, are more than three times as great as the industry's net profit of 1933, nearly four and a half times as great as the industry's profit of 1929, and nearly three times as great as the profits of 1927-1929.

Of the 1238 flour mills that reported in 1933, over 40 percent reported profits totaling $25,000,000 and the rest reported losses totaling $5,000,000, leaving a net income for the industry as a whole of about $20,000,000. During the years 1930, 1931 and 1932 the net profits for the industry amounted to $5,000,000, $13,000,000 and $8,000,000 respectively. In 1929 there were 1348 reports, about 60 percent reporting incomes totaling $39,000,000 and the rest reporting losses totaling $7,000,000, leaving a net profit for all flour milling corporations of $32,000,000 compared with $33,000,000 in 1928 and $37,000,000 in 1927.

The impounded and other unpaid wheat processing taxes amount to $80,000,000. Compared with the net profit of $20,000,000 in 1933, they are four times as great. Compared with the 1929 profits of $32,000,000 they are nearly two and a half times as great; and compared with the 1927-1929 net profits of $34,000,000, the outstanding wheat taxes are also about two and a half times as great. (See Chart 1)

There were 848 meat packing corporations that reported in 1933. Nearly 40 percent of them reported profits of nearly $23,000,000 and the rest reported losses of about $9,000,000, leaving a net profit for the industry as a whole of $13,000,000. Supplementary data for this industry show that profits for the year ending October 1934, when processing taxes on hogs were in effect, were greater than in the year ending October 1933, before processing taxes went into effect. In 1932 the losses of some of the meat packing corporations about offset the profits of others. In 1931 there was a net loss of nearly $21,000,000 and in 1930 a net profit of nearly $18,000,000. In 1929 there were reports from 762 corporations, about 60 percent of them reporting profits and the balance reporting losses, with a net income for the entire group of $22,000,000. In 1928 their net income was $44,000,000 and for 1927, $8,000,000 or an average for those three prosperity years of $25,000,000.

The impounded and other outstanding hog processing taxes of $98,000,000 are about seven and a half times as great as the 1933 profits, about three and a half times as great as the 1929 profits, and about four times as great as the average net profits of 1927-1929. Assuming that on the average about half of the packer's net income is derived from hog operations, these taxes are probably about fifteen times the profits from hogs of 1933, seven times the hog profits of 1929, and eight times the hog profits of 1927-1929.

These comparisons between total impounded and other unpaid processing taxes and the annual earnings for each industry as a whole need to be qualified to some extent, for not all of the processors in a given industry resorted to court injunctions so as to have their processing taxes impounded. The following comparisons between the net incomes and the impounded taxes of the same firms, however, reveal essentially the same fact, that a return of impounded taxes to processors would be, mildly speaking, an outright free gift of public funds.

Of the \$80,000,000 of impounded wheat processing taxes, around \$25,000,000 or about 30 percent goes to only seven companies. The net earnings of these same companies in 1934 were \$6,500,000. For these seven firms, including the largest in the flour milling industry, the impounded taxes are thus more than three times their 1934 net earnings.

To ten meat packers, including the largest firms whose net income in 1934 was \$22,000,000, there are returned about \$50,000,000 or about 50 percent of the total unpaid hog taxes. Ordinarily, packers derive about half of their earnings from hog operations. The \$50,000,000 of impounded and other unpaid hog taxes of the ten packers are thus more than double their 1934 earnings from all meat packing operations and probably nearly four times as great as their earnings from hog operations alone.

The margins taken by processors for converting hogs, wheat and cotton into pork, flour and cotton goods respectively, also indicate how the processing taxes have been collected by the processors from consumers or producers with the original intent of paying them into the U. S. Treasury without depleting their own profit accounts. (See Chart 2)

Meat packers ordinarily charge around 60 cents for processing 100 pounds of live hogs, and in addition get certain returns for byproducts and gains or losses from curing operations. This 60-cent margin represents the operating and

profit margin between the price of 100 pounds of live hogs and the wholesale value of all edible fresh hog products. The processing tax of $2.25 per hundred pounds is thus nearly four times the usual operating and profit margin. Had the packers' usual margin disappeared entirely as a result of the imposition of the hog processing tax, the latter would represent nearly three times their usual margin for all expenses including profits. This fact alone is sufficient to indicate how hollow and ridiculous is the argument of processors that they paid the tax out of their own pockets.

Hog margins during the first half of 1931, 1932 and 1933 were respectively 68, 63 and 56 cents per hundred pounds. During the first half of 1934 when the processing tax averaged $1.93 per hundred pounds, the gross margin was lifted to $2.52. During the first half of 1935 when the tax was $2.25, the gross margin was raised to $2.91; and for January 1936 when the tax was not in effect, the gross margin was almost immediately reduced to its former amount. Compared with 56 cents during the first half of 1933, the margin exclusive of the tax for the comparable period of 1934 was 59 cents; for 1935, 66 cents; and for January 1936, 72 cents.

The average margin during the first half of the three years 1931, 1932 and 1933 before taxes were in effect, was 61 cents. During the first half of the two years 1934 and 1935, the average margin exclusive of the tax was 62.5 cents. In addition, hog packers received about 15 cents more per hundred pounds of hogs from by-products during 1934-35 than during 1931-33, and in the neighborhood of 60 cents more from curing operations (including inventory gains).

Wheat processors have in a similar manner increased their operating and profit margin to cover the amount of the wheat processing tax. During the calendar years 1930, 1931 and 1932, the charges for processing a bushel of spring wheat into flour averaged 42, 36 and 38 cents respectively, or 38 cents for the

three years before the processing tax. The processing tax was in effect between June 1933 and January 6, 1935. For the year 1934, the gross margin was raised to 68 cents and during 1935 to 67 cents over the 38-cent margin of 1932, an increase approximating the amount of the 30-cent processing tax. During January 1936, the gross margin was restored to 36 cents or about to its usual level. During the three years prior to processing taxes, the average operating and profit margin on spring wheat was 39 cents. During 1933, 1934 and 1935 the margin exclusive of the tax was also 39 cents.

Cotton manufacturers, like other processors charged with collecting processing taxes to be turned over to the Federal Treasury, in general increased their margin sufficiently to avoid paying the tax out of their own pockets. During 1929 the charge for processing a pound of cotton into cotton goods (17 constructions) was 13.7 cents including all expenses and profits; in 1930, 12.6 cents. By 1932 it had fallen to 8.9 cents. Cotton processing taxes were in effect during the last half of 1933 and during 1934 and 1935. During 1934 the gross cotton margin was raised to 16.8 cents, and during 1935 to 15.9 cents. In January 1936 the margin was reduced to 13.2 cents. During the three years 1929, 1930 and 1931 the average margin was 12.4 cents. During the three years 1933, 1934 and 1935 the average margin exclusive of the tax was also 12.4 cents.

It has recently been argued by a spokesman of the Institute of American Meat Packers that a number of packers are in financial difficulty and that a return of unpaid processing taxes would help them. Presumably this refers to the small packers, since the large ones made good profits during 1934 and 1935, the two years when the hog processing tax was in effect. The difficulties are said to have begun in the summer of 1935 when "many packers found their existence endangered by the tax." During the two years when the tax was in effect, packers owed the Federal Treasury about $368,000,000. By the fall of 1935, they had paid

$270,000,000 or 66 percent, and the balance of $98,000,000 was diverted from the U. S. Treasury by court action. The industry as a whole made good profits throughout the period when processing taxes were in effect and the total of $270,000,000 was paid into the Treasury.

Financial difficulties of small packers are usually associated (1) with small corn crops such as those of 1925 and 1935, which set in motion rising hog prices, and (2) with the long time competitive struggle between the large and small units -- a struggle which exists in other industries as well. The return of unpaid processing taxes to small packers in difficulty on the ground that their losses would thus be smaller than they would otherwise be, cannot be justified any more than the return of the bulk of the impounded and other unpaid taxes to the few large firms who admittedly have made profits in 1935, as well as in 1934. Nor would a return of the bulk of the unpaid taxes to the few large firms, thus enormously increasing their cash surpluses, help the small firms in their competitive difficulties.

CHART I

IMPOUNDED AND OTHER UNPAID PROCESSING TAXES RETURNED TO PROCESSORS COMPARED WITH NET PROFITS

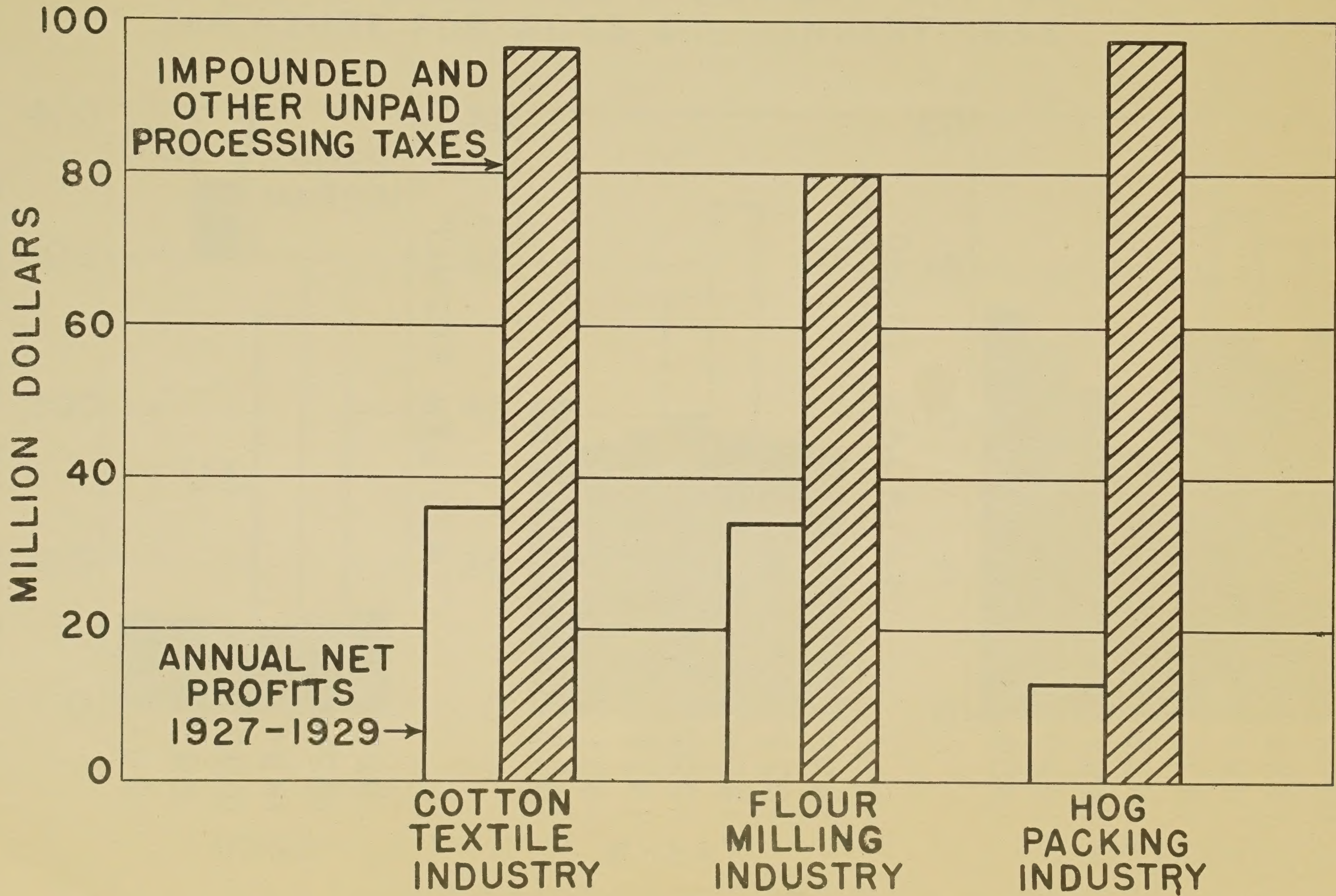

CHART 2

CHARGES FOR PROCESSING COTTON, WHEAT AND HOGS, INCLUDING PROFITS AND PROCESSING TAXES

YEARLY AVERAGE FOR WHEAT AND COTTON, JAN.-JUNE FOR HOGS, AND JANUARY 1936